

GENERAL FUND ESTIMATED SURPLUS/ (DEFICIT)

Prior Year's (2002-2003) Surplus: The Mayor's 2003-2004 Proposed Budget assumes no General Fund surplus or deficit for the current year (2002-2003). However, the Budget Department currently projects a General Fund Surplus of \$708,081, based on its most recent analysis of various General Fund appropriations and revenues.

As detailed below, the Budget Department's projection for the year ending June 30, 2003, consists of a net deficit in revenues of \$30.6 million and a net surplus in appropriations of \$31.3 million.

Surplus/(Deficit) Identified By General Fund Department or Item	Revenue Surplus/(Deficit)	Appropriations Surplus/(Deficit)	Net Surplus/(Deficit)
City Council	\$ (2,513)	\$ 1,762,249	\$ 1,759,736
Finance	(673,965)	2,838,895	2,164,930
Fire	1,781,164	614,835	2,395,999
Health	(1,465,916)	4,173,800	2,707,884
Information & Technology Services	25,000	2,452,702	2,477,702
Law	(115,000)	1,698,168	1,583,168
Planning & Development	279,804	1,156,612	1,436,416
Police	(858,815)	1,878,955	1,020,140
Recreation	(1,100,000)	3,425,551	2,325,551
36 th District Court	1,045,000	136,189	1,181,189
Other Agencies (net)	(4,510,894)	5,321,547	810,653
Non-Departmental	(25,010,600)	7,968,866	(17,041,734)
Fringes	-	(3,292,000)	(3,292,000)
Police and Fire Pensions	-	1,178,447	1,178,447
Total Projected General Fund Surplus/(Deficit)	<u>\$ (30,606,735)</u>	<u>\$ 31,314,816</u>	<u>\$ 708,081</u>

The Budget Department's projection of a \$0.7 million surplus for the year ending June 30, 2003, consists of a net deficit in revenues of \$30.6 million and a net surplus in appropriations of \$31.3 million, as detailed in the above schedule. The appropriation surplus results primarily from vacancies and a mid-year hiring freeze. The revenue deficit results primarily from revenue deficits in Municipal Income Taxes, State Revenue Sharing and Property Taxes.

General Fund appropriations account for about \$1.419 billion, or about 37.5%, of the City's total appropriations of \$3.783 billion in the 2002-2003 Budget.

The Budget Department's current estimate of the General Fund surplus is based on the best available information, as of April 2003, and on various assumptions and projections, and is subject to change.

STATE OF MICHIGAN – BUDGETARY LAWS

The Mayor's Proposed Budget for 2003-2004 is in compliance with the State of Michigan "Uniform Budgeting and Accounting Act" (Public Act 2 of 1968, as amended), which requires a budget whereby estimated expenditures cannot exceed total estimated revenues, so that the budget as submitted is "balanced". This Act states:

"The total estimated expenditures, including an accrued deficit, in the budget shall not exceed the total estimated revenues, including an available unappropriated surplus and the proceeds from bonds or other obligations issued under the fiscal stabilization act or the balance of the principal of these bonds or other obligations."

Michigan Compiled Laws (MCL) Section 141.435, Subsection 15 (2)

The Mayor's Proposed Budget for 2003-2004 does not anticipate a deficit condition for the year ending June 30, 2003. A statement in the Mayor's Budget Message indicated, "We are still working to end this fiscal year with a balanced budget, possibly through the sale of City assets." In accordance with the Glenn Steil State Revenue Sharing Act (Public Act 140 of 1971, as amended), any local unit of government that ends its fiscal year in a deficit condition must submit a financial plan to correct the deficit with the Michigan Department of Treasury. This Act states:

"For a fiscal year of a unit of local government ending on or after October 1, 1980 or any year thereafter, if a local unit of government ends its fiscal year in a deficit condition, the local unit of government shall formulate and file a financial plan within 90 days after the beginning of the fiscal year to correct this condition."

MCL Section 141.921, Subsection 21 (2)

The Mayor's Proposed Budget for 2003-2004 includes a special, one-time financing of risk management payments and a restructuring of debt. The authority for the financing and restructuring is based on the Revised Municipal Finance Act (Public Act 34 of 2001), which relates to the borrowing of money and the issuance of certain debt and securities. This Act states:

"A municipality by resolution of its governing body or by entry into an intergovernmental contract pursuant to section 5 of 1951 PA 35, MCL 124.5, or pursuant to an amendment to a contract adopted and made effective in accordance with the terms of the contract, and without a vote of its electors, may incur debt that shall not be considered debt of the municipality for statutory, charter, or constitutional debt limits, and may issue municipal securities secured by a limited tax full faith and credit pledge for the purpose of ...establishing funds, reserves, or accounts in amounts determined by the municipality to defray losses for which insurance coverage could be provided by an insurer pursuant to the insurance code of 1956, 1956 PA 218, MCL 500.100 to 500.8302, but for which the municipality has determined to self-insure."

MCL Section 141.2513, Subsection 513 (1)(b)

The Mayor's Proposed Budget for 2003-2004 is in compliance with the City Charter (Section 8-204) requirement for a balanced budget. The Charter states:

"The total of proposed expenditures shall not exceed the total of estimated revenues... any surplus or deficit during a current fiscal year shall be entered as an item in the following year's budget".

BUDGET STABILIZATION RESERVE FUND

Detroit's Budget Stabilization Reserve Fund, a "rainy day fund", was established by City ordinance in 1979. City Ordinances 324-H and 341-H provide that one-half of a General Fund surplus for a fiscal year will be included as revenue in the following year's budget and the other one-half of the surplus will be transferred to the Budget Stabilization Reserve Fund. The Budget Stabilization Reserve Fund, accounted for as a reserved portion of the General Fund's fund balance, was established to cover future General Fund deficits, provide funds to restore employees laid off during prior fiscal years, and to cover expenses arising from natural disasters.

The Budget Stabilization Reserve Fund's current balance is approximately \$8.5 million. The following table shows the composition of the approximately \$8.5 million Budget Stabilization Reserve Fund balance and the related surpluses:

<u>Fiscal year</u>	<u>Surplus/ (Deficit)</u>	<u>Deposits</u>	<u>Withdrawals</u>	<u>Fund Balance on June 30</u>
1994-1995	\$ 19,976,648			\$ 0
1995-1996	18,430,053	\$ 9,988,324		9,988,324
1996-1997	12,418,161	9,219,027		19,207,351
1997-1998	13,380,061	6,209,081		25,416,432
1998-1999	1,655,874	6,690,030		32,106,462
1999-2000	2,301,976	827,937		32,934,399
2000-2001	(26,395,130)	1,150,987		34,085,386
2001-2002	1,555,594		\$ (26,395,130)	7,690,256
2002-2003	0	777,797		8,468,053 (A)

(A) Estimated balance

The Mayor's 2003-2004 Proposed Budget does not project a surplus for the fiscal year 2002-2003. If this proves accurate, the Budget Stabilization Reserve Fund balance will remain at approximately \$8.5 million as of June 30, 2003. The actual surplus or deficit for the fiscal year 2002-2003 will not be known until the City's annual financial audit is completed.

RISK MANAGEMENT FUND

Claim and lawsuit payments of the General Fund agencies and Detroit Department of Transportation (DDOT) are accounted for in the Risk Management Fund. In addition, the Risk Management Fund receives earnings from the investment of fund assets and reimbursements from the State.

The Risk Management Fund was established by City Ordinance (Ord. No. 16-95) in 1995. The Ordinance states, "The Risk Management Fund shall cover liability to third parties for any loss or damage whatsoever arising out of negligence, tort, contract or otherwise accruing payable by the City from and after July 1, 1994, and for which insurance could be provided by a third party insurer, but for which the City has determined to self-insure, including, without limitation, any obligation for which the City may be held liable under Workers Compensation or Disability Benefits Law, or under any similar laws, or for damage to property or personal injury, in accordance with applicable law."

Pursuant to the Ordinance and Bond Resolution, the City issued \$100.0 million in self-insurance bonds, and the proceeds were deposited in the Risk Management Fund. In each year since its establishment, premiums from the General Fund and DDOT have been deposited in the Risk Management Fund to cover claim and lawsuit payments.

The Mayor's plan, as outlined in the 2003-2004 Budget Message, is to finance, on a one-time basis, the General Fund and DDOT 2003-2004 premiums payable to the Risk Management Fund, and the debt service remaining on the 1995 self-insurance bonds, with the estimated \$73.0 million proceeds from the issuance of new self-insurance bonds. In addition, the Mayor stated, "In going to the bond markets, we are, in effect, pushing out over multiple years the losses we expect to incur in 2003-2004, paying them out over a four or five year period. I want to emphasize this is a one-shot approach to this problem, designed to minimize the layoffs we have to make now and giving us the time to get our house in order through the Program Management Office."

The Mayor's 2003-2004 Proposed Budget does not include appropriations for the General Fund and DDOT premiums payable to the Risk Management Fund and principal and interest payments due in fiscal year 2003-2004 for the self-insurance bonds. Similarly, the budget does not include revenues from the issuance of new self-insurance bonds. In general, the premiums are appropriated in the General Fund and DDOT and transferred to the Risk Management Fund, the claim payouts are recorded in the Risk Management Fund, and the interest and principal payments are recorded in the Debt Service Fund. A representative of the Budget Department reported that the appropriations and revenues would be included in the City's Budget when the City Council approves the bond resolutions. The representative assumed the details of the bond financing would not be finalized in time to include the revenues and appropriations resulting from the bond financing in the 2003-2004 Adopted Budget. However, it is unclear why the treatment of these bonds should be different than the treatment for other bond issues that are included in the 2003-2004 Proposed Budget (e.g., limited tax bonds issued in the Internal Service Fund).

The following table shows a comparative schedule of budgeted premiums for the Risk Management Fund based on the 2003-2004 Mayor's Proposed Budget, and the 2002-2003 Budget.

Budgeted Appropriations for Premiums (In Millions)			
	2003-2004 Mayor's Proposed Budget	2002-2003 Budget	Increase (Decrease)
General Fund	\$0.0	\$46.1	\$(46.1)
DDOT	<u>0.0</u>	<u>13.8</u>	<u>(13.8)</u>
Total Premiums	<u>\$0.0</u>	<u>\$59.9</u>	<u>\$(59.9)</u>

The table highlights the variances that occurred as a result of not including an appropriation for 2003-2004 risk management premiums in the Mayor's Proposed Budget. The prospective amounts of the claim premiums for 2003-2004 are \$46.3 million for General Fund agencies and \$13.9 million for DDOT, a total of \$60.2 million. The amount of the annual claim premiums is based on a five-year running average of actual payouts on damage claims and lawsuits. A review of the City's claim experience for the past five years indicated that payouts in 1998-1999 and 1999-2000 were higher than the five-year average, while payouts in 1997-1998, 2000-2001, and 2001-2002 were lower than the average (see table on page 43, "Actual Expenditures, Revenues, and Fund Balance"). The \$0.3 million (\$60.2 – 59.9 = \$0.3) increase in the claim premium amounts for 2003-2004 represents a change of less than 1%, although a Budget Department representative expects an increase in claim payouts in 2003-2004. In general, if claim loss experience is greater than premium expenses in any fiscal year, an adjustment to the premium amount occurs in the subsequent year, based on the five-year average formula.

The following table shows costs for each of the ten fiscal years from 1994-1995 to 2003-2004 for premiums for claims (including workers compensation) and lawsuits against the City related to General Fund agencies and DDOT. In addition, beginning in fiscal year 1995-1996, the total appropriation includes debt service (bond principal and interest) on the self-insurance bonds.

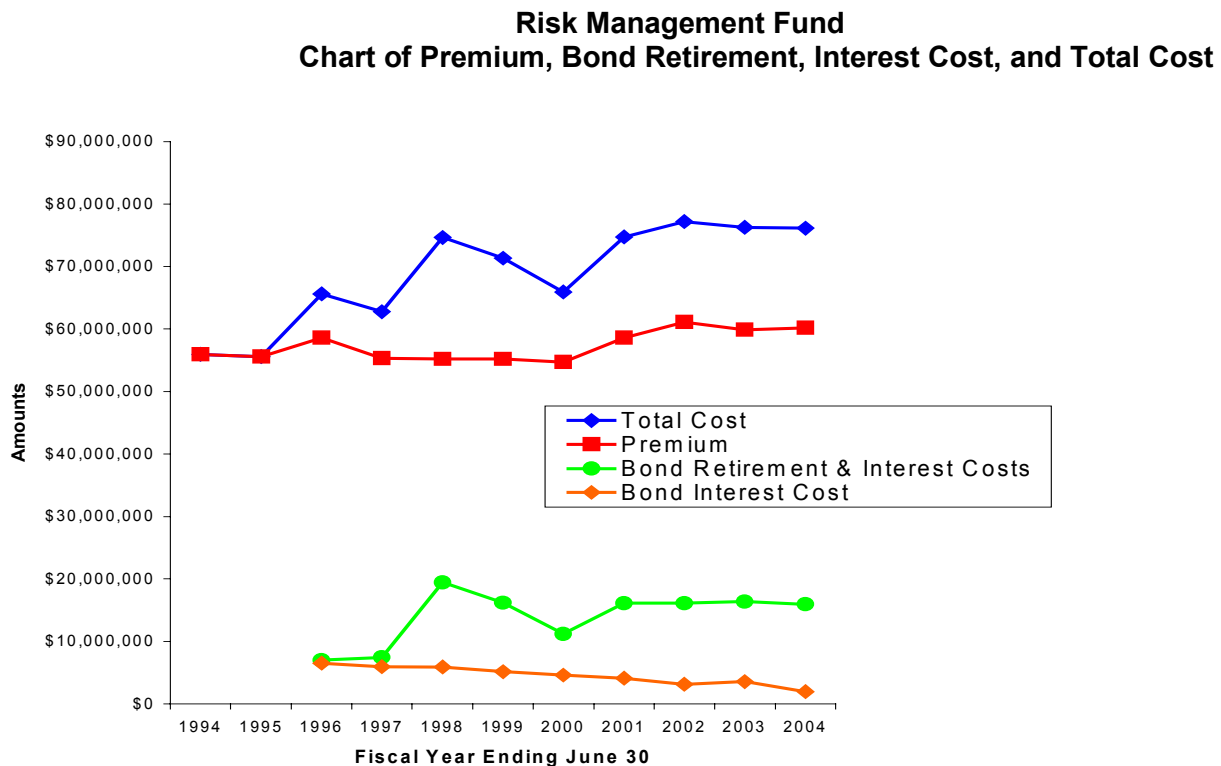
Budgeted Appropriations (In Millions)				
Fiscal Year	Premiums for General Fund & DDOT	Net Bond Retirements	Bond & Interest Costs	Total
1994-1995	\$ 55.6	N/A	N/A	\$ 55.6
1995-1996	58.6	\$ 0.5	\$ 6.5	65.6
1996-1997	55.4	1.5	6.0	62.9
1997-1998	55.2	13.6	5.9	74.7
1998-1999	55.2	11.0	5.2	71.4
1999-2000	54.7	6.6	4.6	65.9
2000-2001	58.6	11.9	4.2	74.7
2001-2002	61.1	12.5	3.6	77.2
2002-2003	59.9	13.6	2.8	76.3
2003-2004 ¹	<u>60.2</u>	<u>14.0</u>	<u>1.9</u>	<u>76.1</u>
Ten Year Total	<u>\$574.5</u>	<u>\$85.2</u>	<u>\$40.7</u>	<u>\$700.4</u>

¹ As stated previously, the Mayor's 2003-2004 Budget will not include appropriations for premiums and debt service for the 1995 Self-Insurance Bonds. We have included the required appropriations for 2003-2004 in the table for consistency with past practices and compliance with City Ordinance No. 16-95.

As shown in the table, over the past ten years, the total Risk Management Fund appropriations for premiums, debt service, and bond issue costs have ranged from a low of \$55.6 million in 1994-1995 to a high of \$77.2 million in 2001-2002. The average total claim premium payment was \$57.45 million for this ten-year period and the average debt service payment was \$14.0 million for the past nine years.

Of the \$100 million self-insurance bonds issued in 1995, \$57.6 million were retired in previous years, leaving a balance of \$42.4 million of bonds payable at June 30, 2002. Based on the amortization schedule, \$13.6 million of bond principal and \$2.7 million accrued interest is scheduled for repayment in fiscal year 2002-2003, leaving a balance of \$28.8 million bonds outstanding at June 30, 2003. In accordance with the Mayor's financing plan, the \$28.8 million bonds outstanding, and accrued interest at the repayment date, will be refinanced in 2003-2004, using proceeds from the issuance of new self-insurance bonds.

The following chart shows costs for risk management premiums, bond principal and interest, and the total of these costs, from the fiscal year ended June 30, 1994 to fiscal year ending June 30, 2004. For fiscal year 2003-2004, the chart reflects the regularly scheduled payments for bond principal and interest, if the Mayor's refinancing plan, which involves early retirement of debt, was not executed.



The difference between the Total Cost line and the Premium line represents the City's additional annual average cost of \$14.0 million for debt service on the 1995 self-insurance bonds. The final payment on the 1995 Self-insurance bonds is scheduled for the 2004-2005 fiscal year, at which time the City's annual cost for self-insurance would drop to the amount of the total annual premium. However, under the Mayor's financing plan, all of the outstanding 1995 self-insurance bonds are slated for retirement in fiscal year 2003-2004. The estimated annual average debt

service for the new issue of self-insurance bonds is \$10 million. The effect of issuing new bonds is to continue the trend of paying higher Total Costs for self-insurance into the future.

The following table shows the actual amount for expenditures, revenues, excess or deficiency of revenues, and fund balance of the Risk Management Fund for fiscal years 1994-1995 through 2001-2002 (the most recently completed fiscal year).

Actual Expenditures, Revenues, and Fund Balance (In Millions)				
Fiscal Year	Claims Expenditures	Revenues	Excess/ (Deficiency) of Revenues	Fund Balance
Beginning Balance				\$100.0
1994-1995	\$ 48.8	\$ 11.3	\$ (37.5)	62.5
1995-1996	57.8	56.9	(0.9)	61.6
1996-1997	52.8	59.2	6.4	68.0
1997-1998	55.6	50.0	(5.6)	62.4
1998-1999	74.0	53.2	(20.8)	41.6
1999-2000	61.8	56.3	(5.5)	36.1
2000-2001	51.7	60.4	8.7	44.8
2001-2002	54.0	60.9	6.9	51.7
Total	<u>\$456.5</u>	<u>\$408.2</u>	<u>\$ (48.3)</u>	

The balance of the Risk Management Fund was \$51.7 million on June 30, 2002. Over the eight-year period ended June 30, 2002, a total of \$456.5 million was paid for claims and lawsuits from the Risk Management Fund. These payouts were financed by \$408.2 million in revenues (primarily General Fund and DDOT premiums), \$48.3 million of self-insurance bond proceeds. The difference between the \$100.0 million in self-insurance bond proceeds and the Risk Management Fund balance of \$51.7 million at June 30, 2002 is the \$48.3 million of bond proceeds used to pay claims.

Based on our analysis of the Risk Management Fund, we note these financial concerns:

- The estimated Risk Management Fund liabilities continue to grow, which indicates that the City has not yet been able to adequately identify and address the causes of damage, liability and workers compensation claims against the City. The City's Comprehensive Annual Financial Report (CAFR) for the fiscal year ended June 30, 2002 included an estimate of Risk Management Fund type liabilities of \$203.9 million. The current portion of this liability, payable within one year, is estimated at \$16.0 million, while the long-term portion of the liability is estimated at \$187.9 million. The total liability of \$203.9 reflects an increase of \$7.7 million over the prior year estimate of \$196.2 million. In the 2002-2003 Office of the Auditor General Budget Analysis, it was noted that the increase over the prior year was \$2.3 million.
- The Mayor's 2003-2004 Proposed Budget understates General Fund Appropriations and Revenues since expenditures for General Fund and DDOT premiums and revenues from bond sales were not included in the budget. The State of Michigan Uniform Accounting and Budgeting Act requires that local governments' budgets include an estimate of the expenditures and revenues for the next fiscal year. To comply with this Act, we recommend the inclusion of the expenditures for General Fund and DDOT premiums and revenues from bond sales in the budget. At the heart of the matter is a value judgment concerning full disclosure in budgetary reporting and the need to make

changes in discretionary expenditures in order to fund the risk management premiums without incurring additional debt. Although the Budget Department ultimately plans to record the appropriations and revenues, it is our opinion that excluding these items from the Adopted Budget is misleading to the general public and other readers of the City's budget documents, and does not comply with the spirit of the Budget Act.

- The Transportation Fund appropriations are understated by \$17.1 million, since the \$17.1 million DDOT premium for the Risk Management Fund is not included in the 2003-2004 Mayor's Proposed Budget. As a result, the General Fund subsidy to DDOT is also understated by \$17.1 million. A representative from the Budget Department indicated that the City intends for the General Fund to "pay" DDOT's claim premium for the 2003-2004 fiscal year with proceeds from the new bond issue. We disagree with the accounting for this plan because it will ultimately understate the true cost of DDOT's operations by \$17.1 million, which are already excessive.
- The balance of the remaining 1995 self-insurance bonds payable on June 30, 2002 was \$42.4 million and is scheduled to be \$28.8 million by June 30, 2003. Refinancing the 2003-2004 and 2004-2005 remaining debt service on the 1995 self-insurance bond issue will increase Risk Management Fund costs, specifically debt service payments, in future years. Any gains that the City makes in reducing its day-to-day risk management claims will be masked, due to high and extended debt service payments for the new self-insurance bond issue, until the new bond issue is paid off. As previously stated, the estimated annual average cost of debt service on the new bond issue is \$10.0 million per year.
- The balance of the Risk Management Fund increased by \$6.9 million, from \$44.8 million on June 30, 2001 to \$51.7 million on June 30, 2002. Since funding the Risk Management Fund with self-insurance bonds, this is the first year that the fund balance has surpassed the outstanding self-insurance bond balance. The issuance of \$73 million in Risk Management self-insurance bonds will reverse this position.

DEPARTMENT OF TRANSPORTATION

The following schedule compares the 2003-2004 Mayor's Proposed Budget appropriations and revenues for the Detroit Department of Transportation (DDOT) operations, including the Detroit Transportation Corporation (DTC - "People Mover"), to the fiscal year 2002-2003 Budget:

	In Millions		
	2003-2004 Mayor's <u>Budget</u>	2002-2003 <u>Budget</u>	Increase (Decrease)
<u>Appropriations:</u>			
DDOT Operations	\$ 149.7	\$ 148.3	\$ 1.4
DTC Support	10.3	10.8	(0.5)
Claims Fund	0.5	17.6	(17.1)
Capital Improvements – Bonds	9.1	7.0	2.1
Total Appropriations	<u>\$ 169.6</u>	<u>\$ 183.7</u>	<u>\$ (14.1)</u>
<u>Revenues:</u>			
State Operating Assistance	\$ 54.6	\$ 57.9	\$ (3.3)
Farebox Revenue	31.3	31.3	0.0
General Fund Contribution to DDOT	57.6	69.4	(11.8)
General Fund Contribution to DTC	10.3	10.8	(0.5)
General Obligation Bond Sale	9.1	7.0	2.1
Other Operating Revenue	0.8	0.8	0.0
Claims Fund Revenue	5.9	6.5	(0.6)
Total Revenues	<u>\$ 169.6</u>	<u>\$ 183.7</u>	<u>\$ (14.1)</u>

The primary difference between the 2003-2004 Mayor's Proposed Budget and the 2002-2003 Budget is the exclusion of the Claims Fund premium and associated debt service appropriation, reductions in the State Operating Assistance Revenue, and the General Fund Contribution to DDOT.

Claims Fund

DDOT has included premiums to the Risk Management Fund and debt service on the 1995 self-insurance bond principal and interest due to the General Fund in the Claims Fund appropriation each year. The premiums provide funding to pay expected DDOT claim (legal and workers compensation) expenditures for the year. DDOT includes Claim Fund Revenue in the budget, for the amount of workers compensation included in the Claims Fund premium, to avoid duplicating the workers compensation expenditures that are also included in their fringe benefits appropriation.

Between fiscal years 2002-2003 and 2003-2004, the Claims Fund appropriation decreased \$17.1 million, from \$17.6 million to \$.5 million, although DDOT risk management claims are not expected to decline. The appropriation decrease is related to the Mayor's plan to finance the General Fund and DDOT 2003-2004 Risk Management Fund premiums and debt service payments for self-insurance bonds with proceeds from a new issue of self-insurance bonds, which is discussed in more detail in the Risk Management Fund analysis section of this report.

A representative of the Budget Department stated that the \$13.9 million DDOT premium and additional \$3.2 million (\$3.7 million estimate less \$0.5 million appropriation) scheduled debt service contribution, totaling \$17.1 million, would not be appropriated in DDOT's Budget. Rather, an appropriation for the Risk Management premium would be made in the General Fund when the new bond resolution is approved by City Council in 2003-2004. We disagree with the decision to make this appropriation in the General Fund. The true cost of DDOT's operations will be understated by \$17.1 million and the necessary General Fund contribution (subsidy) to DDOT is understated by \$17.1 million.

The following schedule illustrates the impact of including the Claims Fund appropriation in the 2003-2004 Mayor's Proposed Budget for DDOT. Without the appropriation, the 2003-2004 Mayor's Proposed Budget shows a decline in appropriations and revenues from 2002-2003 of \$14.1 million. With the appropriation, there is an increase in appropriations and revenues of \$3.0 million over the previous year.

	In Millions				
	2003-2004 Mayor's Proposed Budget	Additional Claims Fund Premium	Adjusted 2003-2004 Budget	2002-2003 Budget	Increase (Decrease)
<u>Appropriations</u>					
DDOT Operations	\$ 149.7		\$ 149.7	\$ 148.3	\$ 1.4
DTC Support	10.3		10.3	10.8	(0.5)
Capital Improvements	9.1		9.1	7.0	2.1
Claims Fund	<u>0.5</u>	<u>\$ 17.1</u>	<u>17.6</u>	<u>17.6</u>	<u>0.0</u>
Total Appropriations	<u>\$ 169.6</u>	<u>\$ 17.1</u>	<u>\$ 186.7</u>	<u>\$ 183.7</u>	<u>\$ 3.0</u>
<u>Revenues</u>					
City Subsidy – DDOT	\$ 57.6	\$ 17.1	\$ 74.7	\$ 69.4	\$5.3
City Subsidy – DTC	10.3		10.3	10.8	(0.5)
Bond Sales	9.1		9.1	7.0	2.1
Farebox Revenues	31.3		31.3	31.3	0.0
Other Operating Revenue	0.8		0.8	0.8	0.0
Claims Fund Revenue	5.9		5.9	6.5	(0.6)
State Operating Assistance	<u>54.6</u>		<u>54.6</u>	<u>57.9</u>	<u>(3.3)</u>
Total Revenues	<u>\$ 169.6</u>	<u>\$ 17.1</u>	<u>\$ 186.7</u>	<u>\$ 183.7</u>	<u>\$ 3.0</u>

As shown above, including the \$17.1 million Claims Fund appropriation in the 2003-2004 DDOT Budget would increase the total appropriations, and the General Fund subsidy. DDOT appropriations would total \$186.7 million or \$3.0 million more than the 2002-2003 Budget. The General Fund Subsidy would increase by an additional \$17.1 million to \$74.7 million or \$5.3 million more than the 2002-2003 budgeted subsidy.

State Operating Assistance

Public Act 51 of 1951 restricts State Operating Assistance for urban public transit agencies, with a population greater than 100,000, to an amount up to 50% of their eligible operating expenses, as defined by the State of Michigan Department of Transportation. An eligible expense reimbursement formula is used to compute the amount of operating assistance that urban transit agencies receive from the State. An adjusted amount of eligible expenses is multiplied by a percentage, determined by the State, to calculate the amount of the distribution to transit agencies. According to the formula, the DDOT receives 65% and the Suburban Mobility Authority for Regional Transportation (SMART) receives 35% of the total distribution amount allocated to the urban agencies. Michigan Department of Transportation documents show, for State fiscal year 2003, October through September, that State Operating Assistance will cover \$55.3 million of DDOT's \$157.7 million Eligible Operating Expenses and the remaining \$102.4 million is the Local Share. Approximately one-third of DDOT's operating expenses are covered by the State Operating Assistance, while two-thirds are paid through Operating Revenues (mostly farebox receipts) and the General Fund Subsidy.

The 2003-2004 Mayor's Proposed Budget includes an estimate of \$54.6 million for State Operating Assistance, a \$3.3 million decrease from the previous budget.

Farebox Revenue

Budgeted farebox revenue is \$31.3 million for 2003-2004; the same amount budgeted for fiscal year 2002-2003. DDOT actual operating revenues, including farebox revenue, have steadily declined over the past five years. In 2002-2003 DDOT raised passenger and student fares by \$0.25. The fare increase should result in more revenue. However, fare increases in the past have discouraged ridership and revenue has not increased as anticipated.

In our opinion, DDOT's proposed 2003-2004 farebox revenue of \$31.3 million for 2003-2004 is optimistic. According to the city's financial system, farebox revenues for the nine months ending March 31, 2003 total \$15.9 million, down \$3.2 million from the nine months ended March 31, 2002. Actual farebox revenue for fiscal year 2001-2002 was \$24.1 million. At the current rate, it is unlikely that DDOT will achieve last year's revenue levels or its budgeted revenue of \$31.3 million for fiscal year 2002-2003. Unless dramatic efforts are undertaken to increase ridership, it is unlikely that DDOT's farebox revenues will grow to the level budgeted for fiscal year 2003-2004.

General Fund Contribution

The budgeted General Fund Contribution to DDOT is \$57.6 million for 2003-2004. The General Fund contribution to DDOT represents an \$11.8 million (17.0%) decrease from the previous year's budgeted amount. As previously noted, the 2003-2004 Mayor's Proposed Budget has not appropriated the Claims Fund premium due the Risk Management Fund and the scheduled debt service for the self-insurance bonds totaling approximately \$17.1 million. As a result, the General Fund Contribution should be increased by \$17.1 million to \$74.7 million, which is an increase of \$5.3 million over the previous year.

Employee Turnover Savings

Employee Turnover Savings, the amount expected to be saved due to temporarily vacant positions, in the 2003-2004 Mayor's Proposed Budget is approximately \$3.9 million for DDOT operator and mechanic positions.

Net Operating Losses

The pattern of the DDOT's net operating losses is well documented, as are the public policy reasons underlying continued subsidies to transit operations. The following schedule details the DDOT actual and expected net operating losses over recent years. The data for this schedule was obtained from the City's Comprehensive Annual Financial Report (CAFR) for fiscal years ended June 30, 1998 through June 30, 2002, Budget Department data for fiscal year ended June 30, 2003, and the Mayor's Proposed Budget for 2003-2004.

In Millions							
<u>Period</u>	<u>Operating Revenue (A)</u>		<u>Operating Expense (B)</u>		<u>Net Operating (Loss)</u>		<u>Transfers from the General Fund</u>
1997-1998	\$ 31.5		\$ 153.6		\$ (122.1)		\$ 53.0
1998-1999	31.4		160.6		(129.2)		51.0
1999-2000	29.0		172.6		(143.6)		60.2
2000-2001	25.1		187.1		(162.0)		74.2
2001-2002	24.1		187.4		(163.3)		79.4
2002-2003	32.1	(C)	165.9	(C)	(133.8)	(C)	69.4 (C)
2003-2004	32.1	(C)	*150.2	(C)	(118.1)	(C)	57.6 (C)

(A) Operating revenue consists primarily of farebox revenue.

(B) Budgeted operating expenses do not include the General Fund contribution for operation of the People Mover, and the Capital Improvement Bonds in 2002-2003 and 2003-2004.

(C) Estimated revenues, operating expenses, net operating loss, and general fund transfers.

* Excludes \$17.1 million in Claims Fund costs

The above schedule clearly shows a trend of declining operating revenue and increasing operating expenses over the past five fiscal years, where actual data is available. Large net operating losses are also expected in the 2002-2003 and 2003-2004 fiscal years.

Conclusion

Based on our analysis, the budgeted revenues and appropriations included in the 2003-2004 Mayor's Proposed Budget for DDOT are not reasonable. Operating expenses and the General Fund contribution are understated due to the exclusion of the Claims Fund premium appropriation. Operating revenues are optimistic based on actual revenues from the past five years.

DETROIT TRANSPORTATION CORPORATION
(PEOPLE MOVER)

In 2003-2004, the City will provide \$19,365,000 to the Detroit Transportation Corporation (DTC), a component unit that oversees the People Mover operations, in the form of a General Fund Subsidy (\$10,265,000) and proceeds from bond sales (\$9,100,000).

The budget for the DTC is not incorporated in the City's budget. The DTC budget was developed in accordance with City mandatory budget cuts. Therefore, the budget reflects a 5% (\$540,000) decrease in the General Fund Subsidy. The following schedule compares the DTC summary budget for fiscal years 2003-2004 and 2002-2003.

	In Thousands		
	2003-2004	2002-2003	Increase (Decrease)
Expenses:			
Staff Expenses	\$ 6,278	\$ 6,330	\$ (52)
Materials and Services	3,312	3,934	(622)
Facility Maintenance and Contract Services	1,719	1,757	(38)
Maintenance and Servicing of Equipment	606	762	(156)
Total Operating Expenses	\$ 11,915	\$ 12,783	\$ (868)
Revenues:			
Faregate Collections, Pass and Token Sales	\$ 520	\$ 615	\$ (95)
Other Revenue	430	260	170
Expected FTA Grant	700	-	700
Final Insurance Settlement	-	1,103	(1,103)
Total Revenue	\$ 1,650	\$ 1,978	\$ (328)
Excess of Expenses Over Revenue	\$ 10,265	\$ 10,805	\$ 540
City of Detroit Subsidy	\$ 10,265	\$ 10,805	\$ 540

The major differences in the DTC revenues and expenses for 2003-2004, as compared to 2002-2003, are outlined below.

DTC Subsidy

The 2003-2004 Mayor's Proposed Budget includes a \$10,265,000 subsidy to the DTC, a \$540,000 decrease from the 2002-2003 Budget. The subsidy represents the excess of budgeted People Mover expenses over budgeted revenues (\$11,915,000 - 1,650,000 = \$10,265,000). The General Fund Subsidy will pass through the Detroit Department of Transportation (DDOT) to the DTC.

The General Fund Subsidy is the primary source of operating revenue for the DTC (the budgeted subsidy represents 86.2% of total operating expenses for the People Mover in 2003-2004). In 2003-2004, the budgeted subsidy cost is \$9.87 for each \$0.50 ride, an increase of \$1.09 from 2002-2003. The increase in the subsidy occurs because the total operating costs are distributed among fewer riders.

Fare-gate Collections, Pass, and Token Sales

The DTC's 2003-2004 Budget includes revenue of \$520,000 from fare-gate collections, pass, and token sales, a decrease of \$95,000 from the 2002-2003 Budget. The passenger fare for the People Mover is expected to remain constant at \$0.50 per ride for fiscal year 2003-2004. However, ridership of the People Mover is expected to decrease in 2003-2004 due to the temporary closing of the Renaissance Center People Mover Station, in connection with the berm removal project. The estimated ridership of the People Mover is 1,040,000 passengers for 2003-2004, as compared to 1,230,000 passengers in 2002-2003. The expected decrease in ridership resulted in the \$95,000 decrease in budgeted fare-gate, pass, and token sales. The Renaissance Center People Mover Station is scheduled to reopen in May 2004.

General Obligation Bonds

The City will issue bonds in the amount of \$9,100,000 in 2003-2004 for the DTC. The proceeds will be used for improvements to the People Mover System (e.g., midlife overhaul and upgrade of People Mover vehicles). The bond proceeds will pass through the Detroit Department of Transportation to the DTC.

Federal Transit Administration Grant

The DTC's 2003-2004 Budget includes \$700,000 revenue from a Federal Transit Administration (FTA) grant, an increase of \$700,000 from the 2002-2003 Budget. Some of the expenses to upgrade and improve the People Mover System will be charged to the FTA grant in 2003-2004. The DTC received a grant from the FTA in 2001-2002. However, the DTC did not receive a FTA grant in 2002-2003. A sizable variance in budgeted grant revenue occurred because the DTC did not receive a grant in fiscal year 2002-2003.

Final Insurance Settlement

In 2002-2003, the DTC received a final insurance payment of \$1,103,000 for damages to the People Mover during the implosion of the J.L. Hudson Building. The damage in cost to the People Mover was \$6,116,000. The DTC received a total of \$5,236,000 from its insurance company and \$689,000 from the company that imploded the Hudson Building. The DTC paid \$191,000 toward the repair of the People Mover. A sizable variance in budgeted insurance revenue occurred because the DTC will not receive an insurance payment in fiscal year 2003-2004.

Other Revenue

The DTC's 2003-2004 Budget includes other revenue of \$430,000, an increase of \$170,000 from the 2002-2003 Budget. This revenue category includes funds from the Beam Escrow Trust Account, which was established February 23, 1990, with the initial deposit of \$3,000,000 by UTDC, Inc. The Beam Escrow Maintenance and Inspection Program was modified this year to allow the DTC to draw down \$220,000 a year from the Beam Escrow Trust Account to cover inspection and maintenance costs.

The People Mover was constructed by UTDC, Inc. The Beam Escrow Trust Account was created for maintenance, inspection, repairs, modifications, reinforcement and rebuilding of the People Mover guideway structure.

Staff Expenses

The DTC's 2003-2004 Budget includes \$6,278,000 for staff expenses, a decrease of \$52,000 from the amount in the 2002-2003 budget. The DTC will reduce staff expenses mainly by minimizing overtime. If necessary the DTC will not fill two vacant positions in 2003-2004 to keep its budget balanced. However, the DTC does not plan to reduce service levels.

Operating Costs

In 2003-2004, the estimated operating cost per rider for the DTC is \$11.46, an increase of \$1.07 from the 2002-2003 Budget. The increase in operating costs per rider occurs because the total operating costs are distributed among fewer riders.

Total Operating Expenses

As shown in the schedule, the \$868,000 decrease in operating expenses is primarily due to the reduction in expenses for materials and services and in maintenance and servicing of equipment. The DTC will receive a subsidy in fiscal year 2003-2004 from the City that is 5% less than the 2002-2003 subsidy. The DTC's rationale for reducing material and services is that it believes some upgrades and improvements to the People Mover system can be postponed. The DTC plans to spend less in maintenance and servicing of equipment in 2003-2004 than in 2002-2003.